Developing a deeper Understanding of DC Pensions

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We know pensions are not simple. We also know, both anecdotally and from industry surveys, that the complexities associated with pension funding often act as a barrier to clients contributing what they should in order to have a comfortable retirement. So we in the industry have a daily conundrum to solve. We know we can offer clients all kinds of funding incentives in terms of tax breaks to start a pension, or to increase their contributions, but many clients, understandably, can find pensions complicated and difficult to navigate.

How can this communications conundrum be solved? I believe the starting point is to clearly establish and communicate to clients what I call 'Pension First Principles', so that we can remove any unpleasant surprises up front, and establish some ground rules. These 'First Principles' may seem obvious to those of us in the industry, but it would be a mistake to assume that clients know these basics. I would summarise these 'Pension First Principles' as follows:

1. Pensions are a long-term investment, which can potentially lead to financial independence in retirement if funded properly and prudently and reviewed regularly.
2. The Government has made available a generous package of tax benefits to assist us to achieve a comfortable retirement.
3. The State contributory old age pension on its own is intended for subsistence only.
4. There is no access to the pension fund until retirement. It is crucial that clients understand the access rules, and are clear that a pension is not an emergency fund, a rainy day fund, or a safety net in the event of unemployment or business failure.
5. Married couples and civil partnerships over the age of 65 currently benefit from an exemption limit in the tax code, which allows such couples to jointly earn up to €36,000 per annum income tax free (marginal income tax relief is potentially available for incomes between €36,000 and €72,000 depending on circumstances). PRSI and USC may apply to the income. This is a significant income tax concession in retirement.

Once these first principles are understood, focus can be brought onto the benefits, security and potential financial independence that private pension funds are capable of providing.

A clear funding objective helps a great deal. The following table outlines the different types of target funds required to provide particular retirement lump sums, together with particular retirement incomes based on a 4% drawdown from the A(M)RF. (The incomes shown would of course be in addition to any State pension.)

The skill is in matching the appropriate target fund to the financial resources of the client (or client company) and in ensuring that the required contributions are within the permitted funding limits or income tax relief limits, depending on the nature of the pension contract.

DC FUND AT RETIREMENT	RETIREMENT LUMP SUM (25% OF FUND VALUE)	INCOME IN YEAR 1 (4% OF A(M)RF)
€400,000	€100,000	€12,000
€600,000	€150,000	€18,000
€800,000	€200,000	€24,000
€1,000,000	€240,000 *(Net)*	€30,000
€1,200,000	€280,000 *(Net)*	€36,000

Source: Irish Life

Irish Life has several pension support documents on B-Line which can help with the all-important pension communications. These aids include a *Turning Company Profits into Personal Wealth* flyer, a *Planning for your Retirement at all Ages* flyer, and a *10 Reasons why Pensions still make Sense* document, to name a few that will assist with pension reviews and pensions campaigns. If you require any further assistance, please contact your Irish Life account manager.

Notes

- Imputed drawdown increases to 5% from the year of the 71st birthday (70th birthday if born on the 1st of January). A rate of 6% applies to ARFs/Vested PRSAs with funds in excess of €2 million.
- ARFs are not guaranteed and can deplete or even bomb out over time during the client's life.
- Tax free cash is capped at €200,000. Any lump sum benefit above this limit is taxed at 20% subject to a cap of €300,000.
- All A(M)RF drawdowns are subject to income tax/PRSI/USC where applicable.
- Targeting funds does not guarantee the funds.

WARNING: The value of your investment may go down as well as up.

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